

EXEMPTING TRIBAL GOVERNMENT DISTRIBUTIONS FROM FEDERAL KIDDIE TAX PROVISIONS

Current Law

Section 1(g) of Internal Revenue Code--popularly known as the "kiddie tax"--was designed to prevent income shifting between wealthy parents and their children, but it currently applies to a wide variety of types of income distributed to children and certain young adults. In general, it applies to any income that is not "earned income" as described in Section 911(d)(2) of the Code. It subjects such unearned income to the parent's higher tax rates. Under the "kiddie tax" rules, unearned income in excess of \$1,900 of children under age 19, or of young adults age 19-24 who are full-time students, is taxed at the parent's highest marginal rate, if that rate is higher than what the child would otherwise pay.

In an IRS Publication 3908 (Gaming Tax Law for Tribal Government), the IRS Office of Indian Tribal Governments advised Indian tribes establishing minors trusts to "take into account the potential tax imposed on certain unearned income of minor children at the allocable parental rate." It further noted that the "kiddie tax" applies not only to children who are under age 19, but also to full-time students up to age 24. Note: Under the kiddie tax, non-gaming as well as gaming income (i.e., virtually any type of income that a tribal government would distribute to a minor or young adult member outside of the employment context) would be subject to the kiddie tax.

Reason for Change

The kiddie tax not only burdens minors and young adults with an inappropriately high tax rate, it imposes compliance burdens on large numbers of taxpayers receiving relatively small distributions from a tribal government. Tribal members who choose to attend college full-time are burdened by these higher tax rates until they attain age 25, which creates a perverse incentive with respect to higher education. From a tax policy perspective, it is inappropriate to treat these government distributions as intergenerational income shifting. Moreover, if they are gaming distributions, the Tribe is required to withhold tax when making the distributions

Proposal

Indian tribal governments have proposed to amend Code Section 1(g) to exempt tribal government distributions (whether derived from gaming or other income) from the kiddie tax.